

Loss Prevention

WHAT YOU WILL LEARN

- Why control of shrinkage is so important to successful retailing.
- How to measure shrink.
- The different types of shrinkage.
- Benchmark statistics to use in assessing your store.
- How to perform a physical inventory.
- How to reduce shrink.

"You must be able to measure shrinkage in order to control it."

"Loss Prevention" is not a very glamorous part of retail. It is, however, an extremely important element of the success equation. Call it what you will, theft or shrinkage is all lost dollars ... and each one of these dollars would otherwise be 100% pure bottom-line profit.

A storeowner with annual sales of \$400,000 and an average 3% shrink is losing \$12,000 from his or her pocket each and every year. In most cases, if true figures were available, it would likely be twice that amount. Shrink is hard to track and most retailers grossly underestimate their loss rates. Any inroads you can make in reducing these losses is money in the bank.

In the last 10 years, employee theft has almost equaled

customer losses as the greatest cause of shrinkage. Paperwork errors remain a distant third. There are a hundred ways for staff to steal and it's economically impractical to cover all the bases.

Winning Facts

(RCC 2000 Survey)

*General Shrink
Breakdown:*

- * 38% customer*
- * 33 % employee*
- * 21% admin. &
paperwork*
- * 8% vendor*

Therefore, the general approach in loss prevention circles is to create the impression that management is aware of all the ways to steal and has checks in place to catch any offenders. In reality, this is not the case, but we hope that the likelihood of apprehension prevents most employees from even trying and keeps them focused on their jobs.

The primary control factor in reducing shortages is management involvement. Only when all levels of management participate in loss prevention programs will shrink gain the necessary visibility as a major company problem. Employees will then realize that the organization is not willing to accept such losses and will understand the importance of proper controls.

HOW MUCH ARE YOU LOSING?

To determine their own levels of shrink and whether or not it is a problem, most retailers use the "gut feel" approach. Unfortunately, this is an entirely inadequate method. Experience has shown that the "gut feel" figure is usually only half of the actual amount. Since each dollar lost reduces bottom-line profit, this is a major problem for almost every retailer. It takes an average of \$10 in additional sales to make up for every "shrink" dollar.

Accurate shrinkage levels should be calculated by comparing an actual physical count of all inventories with the book value of that merchandise. Shrink figures are the difference between these two amounts, calculated in retail dollar values and typically expressed as a percentage of total sales. Book values are obtained by implementing a perpetual inventory accounting system, which can be either manual (see workbook, Chapter 10) or computerized.

Tip

If computerized, the difference between system calculated margin & the financial statement margin for the same period equals shrink.

Computerized point of sale (P.O.S) systems can make the process a lot easier. They allow you to pinpoint specific trouble spots and calculate period gross margins. When compared with financial statement gross margins, they provide another form of shrinkage calculation.

Shrinkage \$ = Book Value of Inventory - Actual Inventory on Hand

Shrinkage % = Shrinkage \$ at Retail Values ÷ Total Sales

Shrinkage Rates by Retail Sector

Activity Sector	Sales Volume	Gross Margin	Shrinkage Rate
Auto Parts	\$500,000 – \$1,000,000	20 – 25%	2.1 – 3%
Books & Magazines	> 1,000,000	26 – 30%	1.6 – 2%
Card & Gifts	600,000 – 1,000,000	Over 40%	1 – 1.5%
Computers & Software	500,000 – 1,000,000	Under 20%	1 – 1.5%
Consumer Electronics	> 10,000,000	31 – 35%	1.6 – 2%
Drug Store	2,000,000 – 5,000,000	26 – 30%	1 – 1.5%

Furniture & Furnishings	500,000 – 1,000,000	36 – 40%	Less than 1%
General Merchandise	2,000,000 – 5,000,000	36 – 40%	2.1 – 3%
Hardware & Home Centre	1,000,000 – 5,000,000	31 – 35%	Less than 1%
Liquor, Wine & Beer	> 10,000,000	36 – 40%	Less than 1%
Recorded Music & Video	100,000 – 500,000	20 – 25%	1 – 1.5%
Shoes	500,000 – 1,000,000	36 – 40%	1 – 1.5%
Specialty Food	> 10,000,000	31 – 35%	1.6 – 2%
Sporting Goods	2,000,000 – 5,000,000	36 – 40%	1.6 – 2%
Toys & Hobbies	2,000,000 – 5,000,000	36 – 40%	1.6 – 2%

Source: Retail Council of Canada: The 2000 Canadian Retail Security Report.

PHYSICAL INVENTORY COUNTS

A physical inventory count is costly and time-consuming. For these reasons, the majority of retailers count inventories only once a year.

Unfortunately, this means they can only calculate shrink once each year, which leaves them vulnerable to a very nasty surprise if gross margins and profitability are not as expected. When major shortages exist, it is too late to react in the current year. On the other hand, if monthly or even quarterly comparisons were made between book values and physical counts, there would be time to rectify any problems before it was too late.

Counting inventory strikes fear in the heart of every retail employee. For most of our staff, coming in early to count stock seems to be a fate worse than death. They have enough trouble arriving in time for a 10:00 AM shift, let alone two hours earlier.

Performing a physical inventory count is also a major production for most retail owners. Fortunately, it doesn't have to be that way when completed on a more frequent basis as part of a proven, systematic program.

The more often you calculate your shrinkage, the better and faster you will become at gathering the necessary data, and (hopefully) the more accurate your calculation will be. Remember that sound business decisions require strong, believable information.

Tip

You will get a more accurate count if you start early in the morning when your staff is "fresh", rather than trying to do it after the store closes.

Key Steps To Perform a Physical Inventory Count

1) Preparation

Keeping the store neat and organized is essential. Start a couple of days before the count to clean up layaways, returns, repairs, etc. Pre-count any merchandise that won't be sold before the official count (i.e. off-season stock, displays, etc.). Make sure no stock is in transit between stores or from the warehouse.

“Chances are if an employee is stealing from you, another employee knows about it”.

Tip

To increase employee participation in fighting internal theft, start a 1-800 “Tip Line” where they can leave a recorded message.

2) After Hours

Some stores try to count stock and ring in sales at the same time. When this happens, you can bet the accuracy of the count is greatly diminished, not to mention the level of service customers get. Count your inventory when the store is closed.

3) Supervision

It is not recommended that store managers perform their own counts unless they are closely supervised by an objective outsider who has no reason to inflate the numbers. More than one store manager and employee have been known to “over-count” inventory to cover up for theft.

4) Draw a Map

The store should be divided into its natural count areas. Have the supervisor draw a map and number each one. An area could be a floor rack, wall unit, table, back room, etc. Every section of the store must be represented on the map, including the ceiling and washroom if merchandise is displayed or stored there. A typical store should have 20 to 30 count areas. Try not to make them too large.

5) Count Sheets

Count sheets should be pre-numbered, printed and padded. The layout of this form (number of lines, column headings, page totals, etc.) will vary by organization. Standard headings should include “Date”, “Store”, “Page Location”, “Counted By”, “Checked By”, “Quantity”, “Price”, and “Description/SKU #”. It is imperative that every count sheet is accounted for (hence the pre-printed numbering and padding).

6) The Count

Each area is systematically counted so checkers can easily keep track of their progress. On a wall section, count top to bottom, left to right. Use a pen (never a pencil) to record quantities on the count sheets. Have the supervisor initial any changes in red ink. After each section is counted and recorded, begin double-

checking, bringing any mistakes to the supervisor's attention. The map and all sheets are then sent to senior management for processing.

Following these steps will not only make your inventory count more accurate, it will also simplify the process so that you can perform these counts much more often.

REWARDS

To reduce theft to its lowest possible level, you must gain the commitment of each and every employee. Loss prevention should be part of all job descriptions and rewards should be offered to those whose suggestions or action have saved the company money.

Incentive programs that reward staff for recovering goods from shoplifters and identifying fellow employees who are stealing not only honour the actions of loyal team members, but also act as a deterrent to other dishonest employees who may think they will never be caught.

Winning Facts

Most common paperwork errors take place during:

- *Shipping & receiving*
- *Recording markdowns*
- *Daily cash reporting*
- *Physical inventory counts*

POLICIES & PROCEDURES MANUAL

Misinformation about all aspects of handling cash and inventory is the main reason for employee mistakes. This can result in discrepancies between book and physical count figures. The larger the organization, the more important it becomes to have an updated policies and procedures manual.

SHARE SHRINKAGE NUMBERS

The shrink figure is not something management should keep to itself. All employees must be aware of how you, and more specifically they, are doing in the battle to control losses. Regular loss prevention meetings must reiterate the cost of such losses, and how it relates to the economic viability of their store and, ultimately, their job.

GREAT CUSTOMER SERVICE

Your best defense against shoplifting is an attentive sales staff that acknowledges and waits on each and every customer. Thieves do not like to be waited on. Stay with your customers as much as possible. Constant staff training on effective selling skills will greatly increase service levels, and hopefully reduce most shoplifting opportunities.

STORE LAYOUT

Blind spots, cash counter placement and merchandise displays must be such that it is impossible for a customer to be in the store without being seen by sales staff. Those stores with a clear, unobstructed view from the outside will create doubt in the shoplifter's mind as to whether or not any one is watching.

Remember, word travels fast if it is easy to steal from your store.

“Electronic security ‘tag’ systems deter the casual shoplifter, not the pros!”

LOSS PREVENTION TOOLS

Depending on the type of retail operation, electronic security systems, security mirrors, video cameras and micro-tag systems all have their place in a proper loss prevention program.

A centrally-monitored security system can reduce insurance rates substantially, as well as provide reports detailing who was in the store and at what time. Security mirrors help eliminate blind spots and security cameras can persuade a would-be thief to move on to an easier target. Micro tag systems are relatively expensive, so shrink figures must justify this type of equipment.

Bear in mind, however, that employees may become too relaxed and stop following basic loss prevention rules when these types of systems are installed. You must remember that they are only one of the many tools available in the fight to reduce losses.

ALONE IN THE STORE

The two main strategies to control internal theft include removing employees' temptation to steal and creating the perception if you do steal, there is a good chance you will get caught.

Remember that there is no greater temptation to steal than being alone in the store when cashing out. This is especially true for individuals experiencing financial difficulty, or those who simply feel they are under-compensated for their efforts.

Tip

Change store locks to ones that have "non-duplicating" keys so you always know how many store keys are out there.

KEY CONTROL

Limit access to store keys as much as possible. Keep a record of who has keys and make sure you retrieve them when employees leave your organization. If keys are not returned, change your locks.

MARKDOWN ACCOUNTABILITY

Winning Facts

Better retail computer systems have loss prevention modules that allow "exception reporting" on various transactions like:

- *Voids
- *Refunds
- *Returns
- *Credit card returns

What is company policy regarding damaged merchandise? Who can authorize a markdown? How are markdowns recorded? How are retail price reductions handled?

All of the above can change the book value of merchandise. Strict policies and procedures must be in place to handle these situations. P.O.S. systems can help to police such procedures by producing markdown reports which highlight any discrepancies between suggested and actual selling prices.

FALSE REFUNDS

False refunds are a popular method for dishonest employees to get cash from the till and still balance at the end of the day. To control this, the customer's name, address, phone number and signature must be recorded on a special form. Spot calls to customers should be made by head office to ensure the validity of refunds.

AUDIT TRAIL

Even the most basic of today's cash registers has many functions that can help management control employee dishonesty. For example, the daily audit trail indicates each time the cash drawer is opened and the reason for it. This report should be initialed by the staff. Ideally, you want the drawer opened only to record sales. If it has to be opened for any other reason, an explanation must be provided. While this procedure works well for many organizations, others may require full reports signed by the manager and/or supervisor.

Depending on the cash register used, the "Z" and "Management" keys allow certain functions to be completed only by the holders of these keys (e.g. cash refunds, voids, daily sales totals, taxes). These keys should not be made available to all employees.

Tip

Be diligent in checking supplier packing slips and invoices, as they also make mistakes.

CONTROLLING THE BACK DOOR

The back door is a prime route for dishonest employees to get merchandise from the store. Therefore, access to and from any back door must be restricted. It should be used only as an emergency exit.

Fire regulations do not permit the permanent locking of most back doors, so you may have to install a "panic bar". This allows exit only in an emergency, but it does not permit entrance.

The front door should be used for all deliveries and staff arrivals/departures.

CHECK THE GARBAGE

Putting merchandise in with the garbage is one of the oldest tricks in the book. Once out at the garbage bin, the dishonest employee has an opportunity to hide the stolen stock so it can be picked up later.

Once again, the idea here is to keep everyone honest by restricting all methods of stealing. Have a second party check all garbage before it leaves the store, or make garbage disposal a two-person job. This would mean that individuals would have to collaborate in order to steal. Consider using clear bags to further reduce the risk.

EMPLOYEE PARCEL CHECKS

This may be a difficult one to implement if it isn't already in place. In this procedure, employees must open and show the contents of all bags leaving the store (including purses) to another staff member. This ensures that they are not leaving with company property.

No one is exempt from this policy, including store managers. If employees don't like this, they may simply choose not to bring their bags into the store.

"Retailers have a tendency to hire each other's thieves."

NEW EMPLOYEE REFERENCE CHECKS

Unfortunately, there is a small portion of the population (approximately 10%) that is always scheming, always trying to get something for nothing. These are the people that we don't want in our system.

Yet, as a group we do a poor job of checking new employee references, especially regarding the reasons for dismissal from past employers. Furthermore, when we catch these bad apples in action, we usually don't prosecute. Therefore, retailers end up hiring each other's thieves.

Tip

When checking references, start with the HR department of previous employers to check employment start and finish dates.

So what should you be doing about this? Start by checking references for all new employees. In particular, have past employers confirm the candidate's start and finish dates. These dates are often fudged when someone has been dismissed from a previous job for dishonesty. As well, try to speak to past immediate supervisors about their work habits, attitude and level of maturity.

EMPLOYEE DISCOUNTS

A generous staff discount can help curb employee theft. It can also compensate for a low hourly wage or salary. To be effective, however, it must be perceived as "generous" by the staff. A 20% discount off the retail-selling price, especially for retailers that average a 50% margin, is not usually helpful in controlling this problem.

All staff purchases should be documented and maintained in a special store file. This allows you to track all discounted purchases for each employee.

SUMMARY

Everything you do to decrease your shrink goes right to the bottom line. Remember to follow these key suggestions:

- 1) Become proficient at performing physical inventory counts at least four times per year and compare these with "book" values to determine shrink dollars.
- 2) Keep the bad apples out of your organization by checking references for all new employees.
- 3) Effective control of shrinkage begins with management commitment.
- 4) Create an atmosphere of confidence that everything is being checked and re-checked.
- 5) Make loss prevention part of your daily routine.

CASE STUDY: LOSS PREVENTION

Now let's get back to the challenges at Jackson's Department Store. In this segment, you will now focus on Loss Prevention.

CHAPTER10: LOSS PREVENTION

Having previously spent time heading up the loss prevention department of a major fashion retail chain, it was your persistence that persuaded Susan and her Dad to put more emphasis on this usually neglected area of retail management.

For the past five years, the company's overall shrink rate has been fairly constant at 2.5% of sales. Like most owner-operated family businesses, the Jacksons felt that the vast majority of this was made up of customer theft. Employee theft was not a problem. As David says, "We treat them like family, so I doubt they would steal from us."

After reviewing with them Retail Council of Canada's national shrink figures, you convinced them that our goal should be a full 1% reduction to 1.5% of sales. On sales of \$1.2M, this is pure, bottom line profit of \$12,000.

Your first chore was to identify which department (if any) was producing more than normal loss figures. Again, the accounting department, with their superb manual systems, was able to give you the following information.

Department	Book Value Jan. 31	Physical Count Jan. 31	Short/ Over	Sales	Shrink %
1. Women's	\$268,100	\$249,900		\$593,000	
2. Men's	\$ 143,050	\$135,450		\$305,000	
3. Children's	\$73,400	\$70,420		\$149,000	
4. Sporting Goods	\$113,100	\$112,00		\$153,000	
Total	\$597,650	\$567,770	\$29,880	\$1,200,000	2.49

Activity: From the following information, calculate the dollar shrink figures for each department and the % shrink figures this represents. What department has the biggest shrink problem?

Answers are found on the following page.

Answers:

Department	Book value Jan. 31	Physical Count Jan. 31	Short / Over	Sales	Shrink %
1. Women's	\$268,100	\$249,900	\$18,200	\$593,000	3.1
2. Men's	\$143,050	\$135,450	\$7,600	\$305,000	2.5
3. Children's	\$73,400	\$70,420	\$2,980	\$149,000	2.0
4. Sporting Goods	\$113,100	\$112,00	\$1,100	\$153,000	0.8
Total	\$597,650	\$567,770	\$29,880	\$1,200,000	2.49

From this, you can see that the women's wear department is considerably over the company average, while sporting goods is way under. It would help to look at previous results from the last inventory count to see if this is a trend or a bookkeeping error. Unfortunately, most retailers do not have accurate shrink figures, so losses can only be tracked by "gut feel". Computerizing your retail process is a much easier way to identify shortages, as products can be tracked by style, size and colour.

Manual systems like Jackson's are the next best bet. Following is an example of how their accounting department tracks inventory using the "Retail Method" of inventory management.

INVENTORY							Opening Inventory
DATE	NET SALES	MARK UPS	MARKDOWN S	OTHER	SHIPPED	RECEIVED	ENDING INVENTORY
Feb. 2	500	10.00	25.00				74,485
Feb. 3	375		10.00				74,100
Feb. 4	425		10.00		2000.00		71,665
Feb. 5	650		30.00			1500.00	72,485
Feb. 6	600	25.00	45.00			500.00	
Feb. 7	750		20.00				
Feb. 8	200		0				
Weekly Total	3500	35.00	140.00		2000.00	2000.00	
Month Total							

- Ending Inventory " Day One" = Opening Inventory " Day Two"
- Opening Inventory – Net Sales + Mark Ups – Markdowns +/- Other – Shipped + Received = Ending Inventory

Activity: From the above data, calculate what the ending inventory figures will be for February 8^h.

Answer is found on page 17 of this chapter.

The Retail Method of Inventory

To track your inventory manually requires the implementation of a simple system known as The Retail Method of Inventory. With this method, you are able to track your inventory levels at their retail values. While this does not give you a concise tracking of your actual dollar investment at cost, it will provide you with the information you need to measure the performance of your investment.

Getting Started

On the above pages, we have provided you with a form for tracking your inventory. To make the administrative aspect of your job a little easier, we have combined the normal inventory document with another form you probably already use on a daily basis, your Daily Sales Report. We assume you already know how to fill out the sales report, so only a few of the blanks are completed in the example. We'll leave the rest to your imagination.

To get started, you need to know the retail value of your current inventory level. This won't take long to count. All you have to do is walk around the

store and work with current retail price points. No need to worry about looking up cost figures. As we mentioned earlier, you'll want to start breaking down your inventory figure into the various departments to better manage performance. Try to limit yourself to four or five departments. Any more than that can become quite cumbersome when you're running a manual system. Once you get your inventory figure, you're ready to begin!

A Few Key Points

The central theme behind this system is knowing how much inventory we have in the store at all times. So each day, we will reduce our inventory by what is sold and increase it by what we receive from suppliers. In addition, we need to reduce our inventory by the amount shipped out to other stores or to a supplier. The idea is to be as accurate as possible. Just think of it as money flowing in and out of your bank account, with periodic adjustments made along the way.

Mark Ups

Let's say you received some earrings from a supplier and originally put them into inventory at \$10. You received 15 pairs, so you added \$150 to your inventory level. Now, you realize that the earrings should have been priced at \$12. You have to change your tickets to reflect the new price. As well, you must post your mark up of \$30 (15 pairs increased by \$2/pair) to your inventory. So the value of your inventory just increased by \$30. That's a mark up calculation and recording.

Make sure you keep track of your markups right away. If you miss recording them, the next time you count inventory you will count a higher dollar value than you have on the books.

Markdowns

Markdowns are a little tougher to track because of their increased frequency. Any time you reduce the price of an item, you must record a markdown.

You have two ways to record markdowns. First, you can record them when the merchandise is sold. So, if you reduced the price of a handbag from \$30 to \$25, you would record a \$5 markdown when the bag was sold. You must record the markdown, or your inventory will only be reduced by the amount of the sale (\$25), when it was originally entered into inventory at \$30. Remember, product has to come out of inventory at the same value it went in. To keep track of these markdowns, simply post a Markdown Sheet near the cash register so staff can record the discount.

The second recording method is what we call a "one time markdown." If you were reducing the same handbag from \$30 to \$25 and you had 10 bags in stock, you would record an immediate markdown of \$50 (10 bags reduced by \$5 each). You would normally only do this type of markdown if the bags were permanently reduced and were not going to go back to regular price. One time markdowns are much simpler to manage.

The Example

The example shown on page 14 is quite simple. You can see that we begin with a Retail Inventory of \$75,000.

On February 2, we had sales of \$500. We also had a mark up of \$10 and recorded markdowns of \$25. No merchandise was shipped or received. So the inventory in the store at the end of the day would now be \$74,485.

$$\$75,000 - \$500 \text{ sales} + \$10 \text{ markup} - \$25 \text{ markdown} = \$74,485$$

Let's look at February 5. Sales were \$650 and we recorded markdowns of \$30. We also received \$1,500 of stock at retail value. So the inventory on hand at the end of the day is \$72,485.

$$\$71,665 - \$650 - \$30 \text{ markdown} + \$1500 \text{ received} = \$72,485$$

You now have a system that will tell you how much inventory you have on hand each and every day.

Answer for the Inventory Level on February 8th is \$71,395.

Tracking by Department

To track sales and inventory by Department, you simply need to set up a form for each Department. You will record opening inventory for that Department and adjust it according to sales of those products, related mark ups/markdowns, and merchandise shipped/received. This process may take a little more time, but the results are well worth it.

Balancing Your Inventory

Now that you have a running tally of your inventory, you can quickly check to see how accurate your stock level is at any time. A fast count of retail values will tell you what amount of stock is missing from either theft or paperwork errors.

In addition, you no longer have to wait until year-end to get a financial statement. Since you have a retail value for your inventory, you can quickly calculate an approximate cost by applying your gross margin percentage (as determined from experience). For example, if you normally have a gross margin of 40% and you have a retail value of \$100,000 in inventory, then your cost of inventory would be \$60,000. Remember, the 40% gross margin is the profit portion of your sales, so the opposite 60% is the cost portion.

Inventory Levels

A good rule of thumb to remember when examining your stock levels is that if a Department represents 30% of store sales, then the inventory in that department should represent 30% of total store inventory. If you have a situation where a particular Department brings in only 10% of sales, yet holds 30% of inventory value, you probably aren't making good use of your investment. The exception is when the profitability of the Department combined with the high value of the individual items, make the investment feasible.

Having a reliable method of measuring shrink goes a long way to combating it. Taking an accurate physical inventory and comparing it to a perpetual book or computer tracked figure is mandatory. Your next step was preparing for a physical count coming up at month's end.

Procedures and methodology for counting must be adhered to religiously. Your plan was to hold a brief staff meeting before the count to go over the procedures you wanted followed.

In addressing other loss prevention issues, you tabled a list of policies and procedures for the next management meeting.

Review the above key areas of loss control to determine how they can be adopted in your retail organization. The best approach is to implement slowly, over a 3 to 6 month period.